ARC & CO. NEW YEAR REAL ESTATE FUNDING REPORT

H2 2023 OVERVIEW AND OUTLOOK FOR H1 2024

JANUARY 2024

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FOREWORD

ANDREW ROBINSON

CEO, ARC & CO. GROUP

Welcome to the **Arc & Co. New Year Real Estate Funding Report 2024**.

In this report, we summarise our H2 2023 performance and reflect on the funding landscape from an advisory point of view. Arc & Co.'s managing director, Edward Horn-Smith, also shares his thoughts on what we can expect in the first half of 2024—a year that has been dubbed a long-awaited 'reprieve' for property developers and investors ready to reignite activity.

For most of 2023, but especially since July, we've identified a distinct shift in client requirements.

As land values, supply chains, and the mortgage market continue to stabilise, residential ground-up development has posed a higher risk than normal.

Consequently, there has been a prevalence of developers sitting tight, increasingly seeking short-term financing solutions while they hold on to sites. Those with completed sites have been subjected to extended sales periods, also leading to an uptick in enquiries for funding to bridge that gap.

Clients have found value in refurbishments, conversions, and the upgrading of existing buildings, as they are acquiring them proportionally cheaper than land in tier one locations. In addition, fewer variables linked to these sorts of projects mean less risk, when compared to ground-up sites.

Operating assets have struggled to attract more leverage due to ICRs affected by the higher interest rates and sector volatility caused by changes to consumer and workplace habits. However, new lenders which don't have legacy books or capital ratio restrictions *are* finding a way to lend, especially in Grade A office, office upgrades, care, and residential portfolios.

It follows that we have broadened our reach into the lending arena to satisfy client requirements, resulting in completions with an even wider variety of providers in H2 2023 when compared to the same period the previous year.

Professional borrowers who have been let down by banks and are further distanced from those institutional relationships are increasingly turning to brokers for advice—The advisory market has generally become more trusted among this calibre of client, and is consequently having an effect on loan sizes which we experience as markedly higher compared to 2022.

At a time of such constant adjustment, more has been demanded of our team. We have taken the opportunity to re-educate our clients on new market offerings, adapting to lender focus and appetite—resulting in the strengthening of our collective experience which we're ready to deliver into the market in 2024.

The data below is based on Arc & Co. H2 2023 completions across all parts of the business. Percentages are worked out on the number of deals written, rather than loan volume.

LOAN VOLUME
£219m

NO.OF DEALS
74

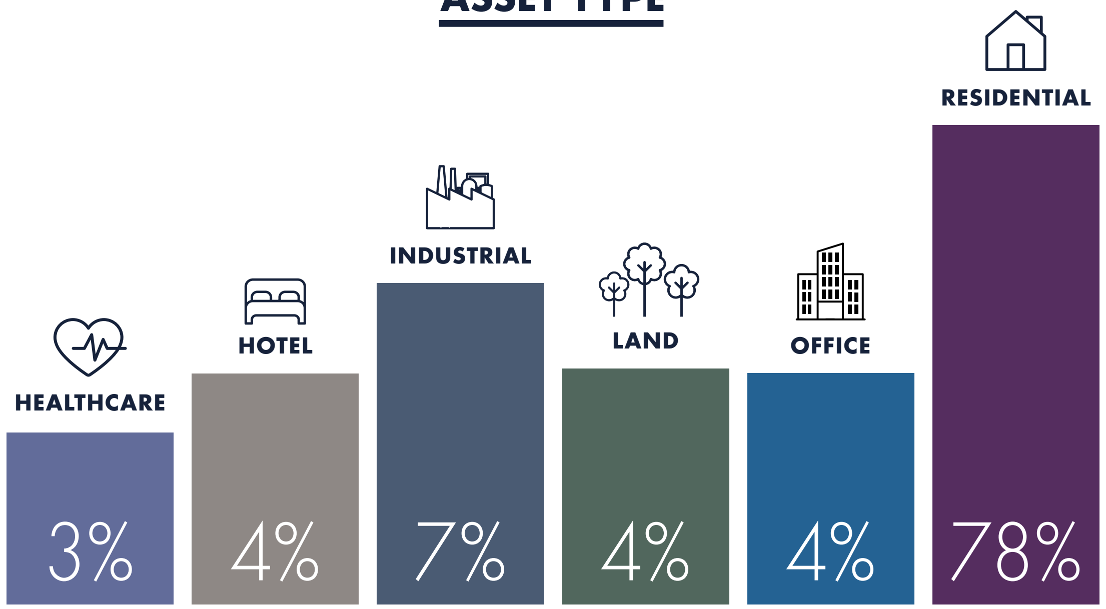
LENDERS USED
40

AVERAGE LOAN SIZE
£3m

SMALLEST LOAN
£99,000

LARGEST LOAN
£25m

ASSET TYPE



LOAN TYPE

Bridge	BTL	Commercial	Development	Residential mortgage
29%	16%	11%	14%	30%

FINANCE TYPE

EQUITY	3%
MEZZ + 2ND	3%
SENIOR	94%

PURPOSE

REMORTGAGE	42%
PURCHASE	52%
FURTHER ADVANCE	6%

LOAN TYPE

PURCHASE 42%	REFINANCE 58%
LTD COMPANY 53%	PERSONAL 47%
NEW 25%	EXISTING 75%

2024 OUTLOOK

EDWARD HORN-SMITH
MANAGING DIRECTOR

Off the back of lower inflation figures, December saw a level of optimism return to the market with five-year swaps finishing 2023 at 3.65 (vs. 5.62 in July).

Despite this positive sentiment leading into the new year and increasing numbers of market participants forecasting base rate decreases in H1, the Bank of England has been at pains to dampen expectations, citing sticky wage inflation and potential geopolitical shocks in the Middle East.

In terms of financing activity for 2024, whilst we hope new investment activity picks up in H1, we think this is more likely to materialise towards the latter half of the year; we stand ready, however, to assist investors and developers with our advice and deep funding relationships.

We still consider refinancing risk to loom large into 2024, with liquidity from alternative lenders such as debt funds and family offices likely to offer more structuring flexibility to fill the 'refinancing gap'.

In terms of asset classes, 'beds and sheds' continue to be in vogue, with significant market liquidity leading to competitive funding terms. Last year saw a resurgence of the hotel and retail sectors and we expect this to continue into 2024 with more funders looking for exposure. We are also big backers of best-in-class office repositioning strategies, and best-in-class PBSA.

Overall, whilst we are optimistic, with high volumes of refinancing expected to be the focus for the coming months, we anticipate momentum to build towards H2 with investors re-entering the market looking for price adjusted opportunities.

LENDER INSIGHT

Broadwood Capital

Dan Smith
Founder and CEO, Broadwood Capital

The ageing population in the UK continues to create challenges and opportunities for the care home sector. The fastest growing section of the UK population is those who are 80+, with people aged 65 – 79 following closely on their heels.

On the supply side, for all newly developed homes which open each year, ones that are outdated and not fit for purpose close. The sector is essentially static in terms of total supply of beds.

Basic economics tells us that growing demand and static supply creates upward price pressure. If only it was that simple! Developing and operating in the sector requires knowledge, skill, and experience.

When it comes to development, the planning process remains cumbersome—and then the home needs to be built, with all the difficulties associated with construction.

Operationally, there is a regulatory framework on care standards and care homes are operating businesses, which come with inherent challenges (eg. cost inflation and availability of staff).

However, for those developers with a proven track record and experience in operating care homes, we see a real opportunity in 2024 to add value to a sector with strong underlying fundamentals and reduced competition.

The specialist nature of care homes can deter many lenders from entering the market, but, at Broadwood, we are excited to be an active and experienced provider of finance in this space.

Tom Cantor
Head of Bridging Finance, West One

In 2024, the outlook for the residential bridging and development sectors already appears more promising than the same period 12 months ago. Looking ahead, we feel the short-term lending markets will remain consistent and even improve upon demand witnessed in 2023.

Recent reports suggest 35% of property sales fell through in 2023 due to surveys, renegotiations and buyer circumstances; these factors will have contributed to the increase in bridging volumes we witnessed last year.

That said, it was a more turbulent market than we are used to. The encouraging signals and movement in the wider mortgage market in 2024 that are anticipated to translate into increased demand for the mainstream residential sector, subsequently benefiting the residential bridging and development sectors.

The more stable base rate environment and improving inflation figures are expected to rekindle investor and owner occupier interest, creating a positive ripple effect in the bridging market. As investor demand gains momentum, it is likely to contribute to the overall growth and stability of the residential bridging sector.

One of the factors influencing the market's trajectory in 2024 will be the impact of the election campaign on the housing market. The outcome of the election and subsequent policies may shape the landscape of property investment, influencing both domestic and international investor sentiment.

In particular, the scrutiny on London as an attractive opportunity for property purchase by international investors will be closely monitored.

West One bridging volumes were up compared to the previous year, and our expectation is for further growth in 2024. We are anticipating an even better performance this year, with hopes high that our respective market shares will expand in line with the overall market growth.

Hugo Sousa
Senior Director, OakNorth

In recent years, many lenders have worked on office deals with aggressive yields and at loan-to-values that are too high and they are now licking their wounds and withdrawing from lending in this part of the market. But, now is actually the time that banks *should* be lending into assets such as offices based on rebased rents and rebased yields.

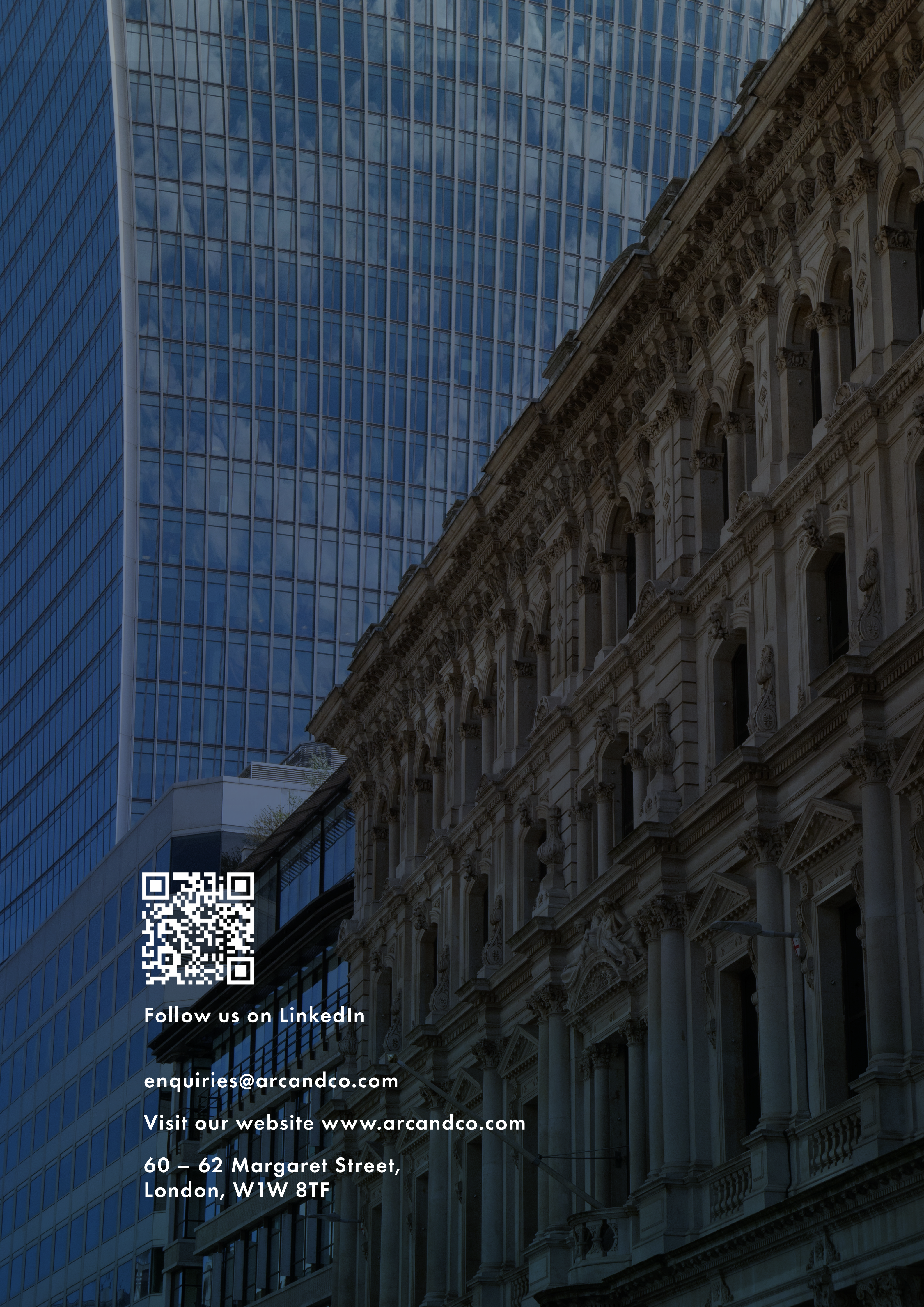
At OakNorth, we're lending based on live, real market rent and live, real market yields, and are very keen to continue to lend through the cycle, especially if it's a category A office or to a business that has a category C/D space that they want to invest in to bring up to category A, or consider alternative use.

Daniel Benton
Director, GRE Finance

As of 2024, the UK office market is set for a dynamic year, influenced by various economic factors. Despite the lasting impacts of the global pandemic, signs of recovery are evident, with economic growth expected to bolster the commercial real estate sector.

As the market undergoes a structural change, a discernible trend is emerging: well-located, high-quality offices and those that offer flexible accommodation will thrive, while poorly situated and low-quality spaces may become unviable, necessitating repurposing in response to a collective shift towards quality. The increasing adoption of hybrid work models further emphasises the need for flexible, technologically integrated workspaces, providing a strategic opportunity for investors to capitalise on this evolving landscape.

GRE Finance, as a value-focused lender believes there is a significant opportunity to support investors in acquiring outstanding office buildings and those seeking to reposition their existing assets.



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